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C O N F I D E N T I A L CARACAS 000101

SIPDIS

NSC FOR TSHANNON
ENERGY FOR D.PUMPHREY AND A. LOCKWOOD

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TAGS: EPET VE
SUBJECT: VENEZUELAN OIL PRODUCTION: A LOOK AHEAD FOR 2004

Classified By: Amb. Charles S. Shapiro; reasons 1.4 (b) and (d)

SUMMARY

¶1. (C) Despite a number of optimistic predictions that Venezuelan oil production will increase by the end of 2004 (which seem largely to be attributable to the success of Venezuelan lobbying efforts in the U.S.), our sources in Venezuela are not as sanguine. While some believe that Venezuela's 2004 production can be expected to remain roughly in the 2.5-2.6 million b/d range where it is generally believed to be at the current time, there are others who believe that, in the absence of significant investment either on the part of PDVSA itself or the international oil companies, Venezuelan production could drop to as little as 2.0-2.2 million b/d by the end of 2004. PDVSA President Ali Rodriguez announced January 5 that PDVSA will boost spending in 2004 with investment of $6 billion out of a total budget of $9.5 billion. If the budgeted money is actually spent, PDVSA may yet be able to arrest the decline, although it faces a tough job. End Summary.

GOV STAYS ON MESSAGE

¶2. (SBU) On January 7, PDVSA spokesmen informed visiting U.S. Congressional staffers that daily production is 3.4 million b/d including condensates, natural gas liquids, and the heavy crude processed into Venezuela,s patented Orimulsion fuel. Despite this posture on the part of the GOV as well as the success of its lobbying efforts in the U.S. (we have seen at least one New York bank analysis stating that production will increase to 2.9 million b/d by the end of 2004), local industry sources continue to be skeptical. With the opposition's competing oil production report not yet out for the month of December, the most recent hard numbers come from the November report which maintains that production in the eastern and western production areas was 1,750 million b/d and 830,000 b/d respectively for a total of 2.58 million b/d. (Note: these are numbers for crude production and do not include condensates and the other products now included in the GOV numbers. In the past, these were not customarily included in Venezuela's production numbers. If PDVSA's current methodology were used, the opposition estimate might look more like 2.8 million b/d. End Note.) While production in both areas appear to have stabilized, the report asserts that PDVSA's own production (1.62 million b/d out of the 2.58 million; production by international operators would be 956,000 b/d) continues to drop slowly.

HOW LOW WILL IT GO?

¶3. (C) Some local sources, such as a consultant who works closely with former PDVSA President Luis Giusti, believe that Venezuela's 2004 production will remain roughly in the 2.5-2.6 million b/d range (without counting condensates, etc.). They believe that modest production increases by the four "Strategic Associations" (i.e., extra heavy crude upgrading projects) as well as by international companies working in Venezuela under operational agreements will serve to make up for continuing losses in PDVSA's own production.

¶4. (C) ExxonMobil de Venezuela President Mark Ward, however, argues that production will continue to decline. Ward, who believes national production has already fallen to or below 2.5 million b/d, told econoff to remember the fundamentals of reservoir decline in Venezuela, i.e., a 20-25 percent annual decline rate that can only be overcome by continuous investment in maintenance of existing projects and development of new ones. With fields that are generally believed to have been operated at the maximum rate in 2003, Ward speculates that the 2004 decline rate may be worse than normal. Ward adds that he sees no evidence of concerted action by PDVSA to address the fundamental issues facing a production operation, i.e., a lack of maintenance of both reservoirs and support systems as well as the failure to do

enough workovers and drilling to support old or new activities. Ward is also skeptical that production increases

by international operators will be sufficient to maintain current production levels.

SOME IOC'S CAN DO MORE

¶5. (C) In a January 6 conversation, Joaquin Moreno, President of Shell Venezuela, confirmed to econoff that Shell has increased its production of valuable light crude from the Urdaneta West field in western Venezuelan to 53,000 b/d. Moreno added that PDVSA is anxious to receive as much oil as Shell can produce and that he expects production from the field to increase to as much as 60,000 b/d in 2004. ChevronTexaco President Ali Moshiri then commented to econoff that, with oil at $34/barrel, all the international oil companies are anxious to produce as much as they can -- or as much as PDVSA will allow or can accept. Moshiri, however, pointed to another problem -- infrastructure. According to Moshiri, ChevronTexaco's Boscan field in western Venezuela is currently producing 115-118,000 b/d. If PDVSA were to ask that Boscan production be increased to 130,000 b/d ChevronTexaco could do it quickly, he added, but PDVSA would be unable to lift the crude. Moshiri underlined that the infrastructure must be there to handle the product, marketing and transportation. He said that chaos still reigns in PDVSA's crude trading and shipping functions and that the current inefficient system can only handle a maximum of 2.5-2.6 million b/d.

¶6. (C) For his part, ExxonMobil's Ward acknowledged that there will be "some small incremental increases from the IOC's," but he does not believe that the increase will be enough to offset the natural decline rate. Ward added that the Hamaca project (ConocoPhillips/ChevronTexaco extra heavy crude upgrading project; the fourth and last of the so-called "Strategic Associations"), the only big project expected to come on line in 2004, is already producing crude at or close to what will be its base level of production. Further expansion of this or other of the Strategic Association projects will be impeded by the fact that they use shared pipelines and, of course, by the fact that the GOV has not moved ahead quickly with negotiations to allow expansion of these projects. (Note: Vice Minister for Hydrocarbons Luis Vierma informed econoff January 7 that PDVSA will meet with Total the week of January 12 to discuss the expansion of the Sincor project, the Total/Statoil Strategic Association.) No other larger projects are due to be turned on until the ExxonMobil La Ceiba field and the ConocoPhillips Corocoro field start production in 2005 (these were both projects originating in profit sharing deals inked in 1996).

PDVSA,S PLANS

¶7. (C) Long time observers of Venezuela's oil scene, such as ExxonMobil's Mark Ward, say that Venezuela must invest in the range of $3-4 billion a year in order to stay ahead of its decline curve. Ward stated bluntly to econoff that PDVSA would have to invest $8 billion in 2004 in order to recover lost production. PDVSA has not made its 2003 spending figures available yet, although the Finance Ministry has reported that PDVSA's overall budget was cut by $2.6 billion from its original $8 billion in 2003. PDVSA President Ali Rodriguez announced January 5 that PDVSA will boost spending in 2004. He said that PDVSA's total budget will be $9.5 billion (15.2 trillion bolivars) with investment comprising $6 billion (9.64 trillion bolivars). However, in a January 7 meeting with U.S. Congressional staffers, Vice Minister Vierma told econoff that PDVSA's investment budget in 2004 will be $5 billion.

¶8. (SBU) In an investment summary presented to U.S. Congressional staffers on January 7, PDVSA claims it will invest $35.4 billion during 2004-2009. According to the presentation, about $13 billion will be invested in production over the next five years. It also predicts that production capacity will be 5.04 million b/d by 2009. (Note: In November 2003, PDVSA announced that its 2004-2009 investment program envisioned investing $39 billion to raise production capacity to 4.8 million b/d in 2009. An earlier version contemplated an investment of $43 billion to yield a

production capacity of 5.0 million b/d. We are not sure how an investment program that seems to have been cut by almost $8 billion according to the January 7 presentation will yield the same results. It is also worth remembering that, in 1998, PDVSA was talking about achieving a 6 million b/d capacity by ¶2006. End Note)

¶9. (C) PDVSA has also announced that it will itself develop the Ceuta-Tomoporo field, the crown jewel of possible new oil

projects that had multiple international oil companies lined up to express their interest. The Ministry of Energy and Mines had stated publicly in late 2003 that Tomoporo would be spun off to a third party contractor in a bid process. The Caracas rumor mill, however, holds that PDVSA President Ali Rodriguez went directly to President Chavez to protest, saying that the new PDVSA had to be able to show that it could take on such a project. PDVSA has also stated publicly that it will itself develop other major new projects. Where the money will come from for development of these projects is unclear.

COMMENT

¶10. (C) PDVSA may yet be able to arrest Venezuela's production decline if it moves ahead quickly with substantial investment in maintenance of existing projects and development of new ones. ExxonMobil's Ward, however, believes that PDVSA could reach a point where it would be impossible to invest fast enough to arrest the decline and save itself. The hard fact is that the 2002-2003 oil strikes followed on two other events that boded ill for Venezuelan oil production: 1) the end of an investment cycle by the international oil companies that had seen some $20 billion in investment since the early 1990's; and 2) the dimunition of PDVSA's own investment since the beginning of the Chavez government. And, of course, the investments by the international oil companies ground to a halt because of the changes in the regulatory environment fostered by the Chavez government. No new projects have been developed since the passage of the Hydrocarbons law in 2001 and this government's antipathy towards allowing major new involvement by international oil companies in the oil sector (as opposed to off-shore gas projects) seems to continue as the recent announcement about the Tomoporo field demonstrates. Even if the political and regulatory environment were to improve substantially in 2004, there would be a significant lead time before this would be reflected in improved production numbers.
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